

Report  
of the  
Examination of  
Catholic Knights  
Milwaukee, Wisconsin  
As of December 31, 2000

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November 16, 2001

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Commissioner of Insurance  
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Commissioners:

In accordance with your instructions, a compliance examination has been made of the  
affairs and financial condition of:

CATHOLIC KNIGHTS  
Milwaukee, Wisconsin

and this report is respectfully submitted.

## I. INTRODUCTION

The previous examination of Catholic Knights (the "society") was conducted in 1996  
as of December 31, 1995. The current examination covered the intervening period ending

December 31, 2000, and included a review of such 2001 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the society's operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Growth of Society
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the society's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the society to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the society's operations is contained in the examination work papers.

The society is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

**Independent Actuary's Review**

Independent actuaries were engaged under a contract with the Office of the Commissioner of Insurance. They reviewed the adequacy of aggregate life and accident and health reserves, refunds to members, cash flow testing, deferred and uncollected premiums for life insurance, due and uncollected premiums for health insurance, and in force testing. The results of their work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuaries' conclusion.

## **II. HISTORY AND PLAN OF OPERATION**

Catholic Knights is a fraternal society licensed as an insurer under chapter 614 of the Wisconsin Statutes. The corporation was originally organized on February 17, 1885 as the Catholic Knights of Wisconsin, under Wisconsin laws applicable to fraternal benefit societies. In 1958 the society broadened its fraternal mission and business scope beyond the state of Wisconsin, and changed its name to Catholic Knights Insurance Society. In 2000 the society's name was changed to Catholic Knights, the name presently used by the society.

The society is a non-profit, non-stock fraternal membership organization. Ownership and control of the society is held and exercised by society members who are over the age of 16. The purpose of Catholic Knights, as stated in the society's articles of incorporation, is to exist solely for the benefit of the members of the society and their beneficiaries, for the conduct of fraternal activities that provide to society members social, religious, benevolent, and intellectual improvement, to engage in the insurance business and other reasonable incidental businesses, and to engage in any lawful socially beneficial non-business activity as determined by the board of directors. Society fraternal activities are conducted through the voluntary participation of the members of the society, through a representative governmental body that consists of 130 local society branches and a democratically elected supreme governing Council. Membership is limited primarily to members of the Catholic religious faith and their immediate families.

There were numerous amendments to the corporate bylaws and the articles of incorporation during the period under examination. Amended bylaws added formalized procedures for the nomination and qualification of delegates to the Triennial Council, amended the eligibility qualifications for election of Council delegates, made changes in committees of the Council, and modified the categories of the society's executive offices. Additional bylaw changes modified the provisions for society membership, restated society maintenance of solvency provisions, and modified provisions pertaining to local society branches with regard to branch establishment and dissolution, branch meetings, and branch officers.

Amended bylaws were adopted with regard to the resolution of disputes between individuals and the society. The amended bylaws provide that certain classes of disputes may not

be adjudicated through lawsuit against the society. Disputes that are subject to these bylaw provisions may be resolved solely through a three step process that includes initial appeal within the society, followed by mediation by an agreed upon neutral third party or the American Arbitration Association, followed by final binding arbitration through an agreed upon neutral third party or the American Arbitration Association.

Amendments to the society's articles of incorporation modified the classes of society membership and membership eligibility requirements, and modified the limitations on member's eligibility to serve as local branch officers.

The society's insurance business is concentrated in a four-state territory, with most of the direct premiums written in the state of Wisconsin, as reflected in the following summary:

**2000 Direct Premium Payments Received from Members**

Wisconsin	\$26,537,415	83.0%
Iowa	2,174,661	6.8%
Illinois	1,805,093	5.6%
Minnesota	1,283,028	4.0%
All other states	<u>183,824</u>	<u>0.6%</u>
	<u>\$31,984,021</u>	<u>100.0%</u>

The society is licensed in eleven state jurisdictions, including the states of California, Florida, Illinois, Indiana, Iowa, Michigan, Minnesota, North Dakota, Pennsylvania, South Dakota, and Wisconsin.

The primary lines of insurance policies written by the society are whole life, term life, and annuities. Insurance products marketed by the society, and the respective 2000 net premiums and annuity considerations by line of business, are summarized in the following table:

**2000 Net Premium and Annuity Considerations**

Life Insurance Premiums:

Regular Life	\$ 4,651,813	
Paid-up Additions, Life	1,508,860	
Knight Life	14,089,725	
Custom Knight Life	1,879,850	
Single Premium Knight Life	946,250	
10 Pay Rider	290,504	
Single Premium Rider	<u>87,862</u>	
Total Net Life Insurance Premiums		\$23,454,864

Annuity Considerations:

Long-term Annuity	\$ 8,504,402
Short-term Annuity	137,540
Single Premium Deferred Annuity	657,509
Immediate Annuity	<u>399,921</u>

Total Annuity Considerations 9,699,372

Accident and Health Premiums:

Renewal Accident and Health	67,654
A&H Premium Earned and Uncollected	<u>(445)</u>

Total Net Accident and Health Premiums 67,209

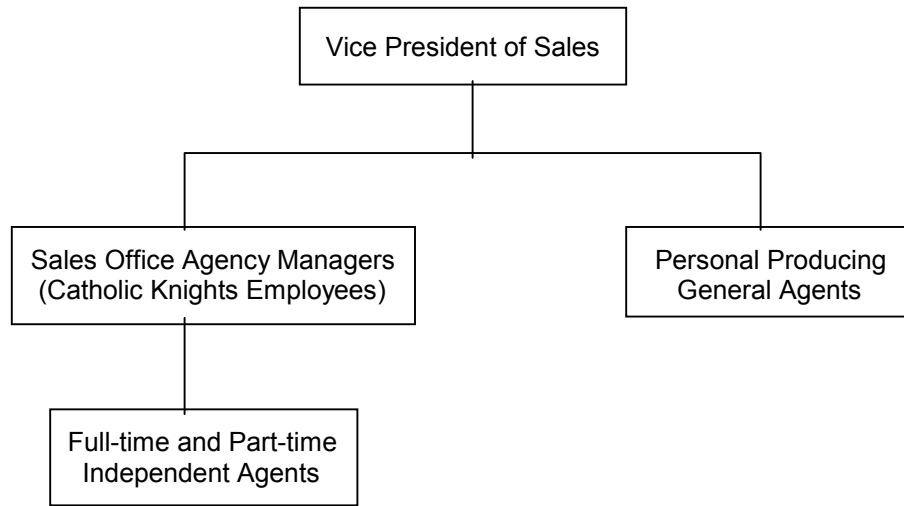
Total 2000 Net Premium and Annuity Considerations \$33,221,445

The products Knight Life, Custom Knight Life, and Single Premium Knight Life are interest-sensitive life insurance policies for which the interest rate is periodically determined by the board of directors. Flexible Annuity products are offered with varying surrender charge provisions, providing to an insured higher interest rates for longer term contract commitments. The society discontinued writing new accident and health insurance policies in 1974, and thereafter its accident and health business has been written solely on a renewal basis.

The society's marketing operations are structured as seven regional sales offices located in Wisconsin, Minnesota, Illinois, and Iowa. Insurance products are marketed through a general agency system comprised of field operations agency managers, who are Catholic Knights employees, and independent contractor producing agents. The agency system at the time of examination fieldwork consisted of seven agency managers, forty full time and seven part time independent producing agents, and one personal producing general agent. The following organization chart depicts the agency system:



### Marketing Organization



The following chart summarizes the direct and net insurance premiums written by the society in 2000. The growth of the society is discussed in the Financial Data section of this report.

### 2000 Written Premiums

Line of Business	Direct Premium	Reinsurance Assumed	Reinsurance Ceded	Net Premium
Conventional life	\$ 6,651,787	\$ 0	\$491,112	\$6,160,675
Interest-sensitive life	17,575,845	0	281,655	17,294,190
Annuities	9,699,372	0	0	9,699,372
Accident and health	<u>67,209</u>	<u>0</u>	<u>0</u>	<u>67,209</u>
Total All Lines	<u>\$33,994,213</u>	<u>\$ 0</u>	<u>\$772,767</u>	<u>\$33,221,446</u>

### **III. MANAGEMENT AND CONTROL**

#### **Membership**

Society membership is open to any individual who is included in at least one of the following categories: (a) a Catholic, (b) a spouse, child, or grandchild of a Catholic, (c) an employee of the society, (d) an employee of a Catholic institution, or (e) as otherwise deemed qualified for membership as determined by the board of directors. A member is an individual who meets the membership criteria and who has had his or her membership application accepted. A member is not required to be a policyholder of society insurance or annuity products.

Members who are at least sixteen years old have the following rights and benefits:

1. The opportunity to participate in insurance, financial, and investment products and services produced by the society and its subsidiaries,
2. The right to participate in the social, intellectual, educational, charitable, benevolent, moral, fraternal, patriotic, and religious activities of the society,
3. The right to vote for delegates to the Triennial Council and to vote and participate in local branch affairs including serving as a branch officer other than branch President, Vice-President, or Secretary/Treasurer, and
4. Additional benefits and rights as may be granted by the board of directors.

Total life and annuity policyholder membership of the society during the years under examination is summarized as follows:

**Catholic Knights  
Membership Statistical Data  
For the Years 1996 to 2000**

<b>Year</b>	<b>Members</b>
1996	79,170
1997	79,309
1998	78,498
1999	77,171
2000	75,506

## **Triennial Council**

The society's bylaws provide that the supreme governing body of the society is the Triennial Council. The Council has the power to make and adopt bylaws providing for the society's government and management. The regular meetings of the Council are convened on a triennial basis. The Council consists of the society's board of directors, and of delegates elected to the Council by the members of the 130 local society branches. The elected delegates must be Catholic members of the society who are also insurance policyholders. Each local branch of the society is a body of society members within a Catholic parish.

The Council elects the society's President and the majority of the society's board of directors at the Triennial Council meeting, and exercises the authority to amend society bylaws and the articles of incorporation and to direct the affairs of the society. Special meetings of the Council may be called by the board of directors or by the filing of written petition signed by 50% of the delegates of the preceding regular meeting of the Council. The most recent regular convention of the Council was the 44<sup>th</sup> Triennial Council, held in October 2000. The 2000 Council consisted of 375 voting delegates, officers, and board members, representing all 130 branches of the society. The next regular Triennial Council meeting will be held in October 2003.

## **Board of Directors**

The society's board of directors has thirteen voting members. The Triennial Council elects ten of the voting directors, and the elected directors appoint three additional voting directors. Of the appointed voting board members, one must be a Catholic priest, one must be a Catholic member of the society with expertise in the business of the society, and one is the individual who occupies the office of society Secretary/Treasurer.

The elected directors, who include the board President, are elected at the Council's triennial convention to serve a three-year term of office. The director appointed from the clergy and the director who is society Secretary/Treasurer each serve a three-year term of office on the board, concurrent with the term of the ten elected directors. The director who is appointed on the basis of having society business expertise serves a one-year term of office. The board has

authority to appoint a Chairman of the Board as an additional member of the board of directors, to serve in the capacity of a non-elected and non-voting board member.

Each director who is not an officer of the company currently receives an annual retainer fee of \$4,300 for serving on the board. A director is paid \$800 for each board meeting attended, and is paid \$150 for each board committee meeting attended if the committee meeting is held on a day other than the day of a board of directors meeting. The society reimburses a director for personal expenses incurred for any branch meeting or function attended by the director in his capacity as a member of the society's board of directors.

The terms of office of all current elected board members, and the appointed terms of the director from the priesthood and the Secretary/Treasurer, expire December 31, 2003. Each elected director is subject to re-election at the October 2003 Triennial Council meeting, and each appointed director is subject to reappointment by the board following the 2003 Council meeting. The term of the current appointed director having society business expertise expires May 2002, and is subject to reappointment in 2002.

Currently the society's board of directors consists of the following persons:

<b>Name and Residence</b>	<b>Principal Occupation</b>	<b>Term Expires</b>
Arlene Houlihan	Director of Health and Cancer Detection Center	2003
Mary Ann Hughes	Retired	2003
Janet Stelken	Vice President, Family Owned Business	2002
William McCarty	Attorney	2003
Rev. Richard Mirsberger	Pastor, St. Rita's Church	2003
William O'Toole	Director of Development Sisters of the Divine Savior	2003
Karen Philleo	Retired	2003
Charles Rebek	President, Security Planning Associates	2003
Scott Roberts	President, Wargo & Company	2003
Lawrence Stephens	Sales Representative Johnson Controls	2003
Edward Ward	Account Executive	

	Dean Witter Reynolds, Inc.	2003
Daniel Steininger	President, Catholic Knights	2003
Allan Lorge	Secretary/Treasurer Catholic Knights	2003

## Officers of the Society

As provided by society's bylaws, the principal executive offices of the society are the offices of President, Secretary/Treasurer, one or more Vice Presidents, and the Chairman of the Board. The President is elected by the membership of the society at the Triennial Council. The Secretary/Treasurer and Chairman are filled by board of director selection and appointment at the first board meeting following the Triennial Council meeting. Vice Presidents are appointed to office by the President, subject to confirmation by the board of directors. The office of Chairman is currently unoccupied, and a Chairman has not been appointed to office during the years under examination. Further examination comment regarding society officers is included in the findings section of this report captioned "Corporate Executive Officers."

The officers serving at the time of this examination are as follows:

<b>Name</b>	<b>Office</b>	<b>2000 Compensation</b>
Daniel J. Steininger	President and CEO	\$247,029
Allan G. Lorge	Secretary and Treasurer and CFO	168,008
Michael Stivoric	Vice President Fraternal Relations	141,887
Daniel H. Strasburg	Vice President and Chief Actuary	137,320
Russell J. Kafka	Vice President – Investments	132,995
Allen A. Banoub	Vice President - Chief Marketing Officer	123,240
Frederick W. Muenkel	Vice President – Member Services	116,896
Susan S. Ellmaurer	Vice President – Data Processing	116,574
Mary C. Bowser	Vice President – Human Resources	112,653
Ted Zimmer	General Council	104,416

## Committees of the Board

The society's bylaws authorize the board of directors to establish committees as deemed necessary, with no requirement for the formation of any specific committee. There are currently four active standing committees of the board of directors. Each standing committee reviews the policy recommendations of management and the operations of the various departments, which regularly report to the respective committee. Standing committees generally meet at least quarterly, their regular meetings being held on the same day as the board of directors meeting. The committees meet in the morning and report to the board at the afternoon board meeting. Current board of director standing committees and their memberships are as follows:

**Executive Committee**

Daniel J. Steininger, Chair  
William O'Toole  
Mary Ann Hughes  
Scott Roberts

**Finance and Operations Committee**

William O'Toole, Chair  
William McCarty  
Edward Ward  
Allan Lorge, Member and Management Contact Person

**Sales, Product and Marketing Committee**

Scott Roberts, Chair  
Karen Philleo  
Charles Rebek  
Larry Stephens  
Allen Banoub, Management Contact Person

**Fraternal, Branch, Church, and Government Relations Committee**

Mary Ann Hughes, Chair  
Arlene Houlihan  
Janet Stelken  
Father Richard Mirsberger  
Mike Stivorik, Management Contact Person

**Management Committees**

In addition to the standing committees of the board of directors, the board has established numerous management committees to provide oversight for managerial functions. There are three primary management committees and a variety of feedback groups, standing management committees, and task forces, established on an as-needed basis to address specific issues. The primary management committees are the President's Roundtable, responsible for operations, daily management, and implementation of the annual business plan; the Brand Development Group, which meets as necessary for initial evaluation of new products, new marketing strategies, and other new corporate initiatives; and the Operations Group, which meets as necessary to assure efficient operations. Other management committees perform oversight and management functions with regard to numerous aspects of society operations, including matters of agency operations, human resources, branch office management, policy rates, compliance issues, computer systems, and interdepartmental operations.

### **Triennial Council Committees**

Society bylaws provide that the President shall appoint, preliminary to an approaching regular meeting of the Council, numerous committees to serve in various planning, advisory, credentialing, and other procedural functions in connection with the society's Triennial Council meeting.

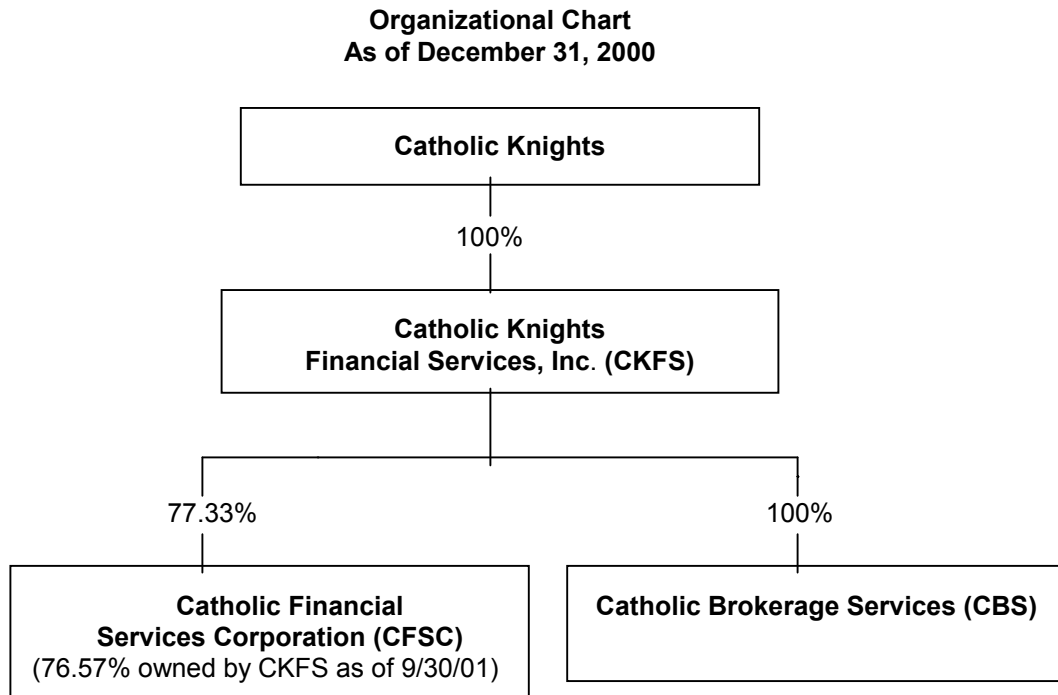


#### IV. AFFILIATED COMPANIES

Catholic Knights is a member of a holding company system. The society organized three subsidiary corporations in 1994, comprised of a non-operating intermediate holding company subsidiary and two operating subsidiaries.

The society's licensure authorization is for the conduct of traditional life, annuity, and accident and health insurance business. The society established its holding company subsidiaries to enable the society to offer to its members certain financial and investment services that are outside the society's insurance licensure authority, and to enable the society to offer insurance products written by other insurance companies. The society's objective in its holding company operations is to offer a wide range of financial products and services to members and to thereby establish and maintain a competitive market position relative to competing insurers.

The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the significant affiliates of the society follows the organizational chart.



**Catholic Knights Financial Services, Inc.**

Catholic Knights Financial Services, Inc. (CKFS) was incorporated June 1, 1994 as a Wisconsin domiciled stock corporation. All of the issued and outstanding CKFS capital stock is issued to and held by Catholic Knights. CKFS exists as a non-operating subsidiary of the society, and serves as the administrative holding company for the society's operating subsidiaries.

As of December 31, 2000, the audited financial statements of CKFS reported total assets of \$959,879, total liabilities of \$226,754, and total shareholders equity of \$733,125.

Consolidated operations for 2000 produced a net loss of \$553,423.

**Catholic Financial Services Corporation**

Catholic Financial Services Corporation (CFSC) was incorporated June 1, 1994 as a Wisconsin stock corporation subsidiary of CKFS. From the formation of CFSC in 1994 through November 1, 1998, CKFS owned 100% of the 1000 initial shares of issued CFSC common capital stock.

CFSC issued 500 additional shares of capital stock in December 1998, of which 160 shares were purchased by CKFS. Two independent Catholic fraternal benefit societies purchased the remaining 340 shares of CFSC capital stock issued in 1998, the Catholic Order of Forresters having purchased 300 shares and the Catholic Knights of America purchasing 40 shares. CFSC issued an additional 15 shares of capital stock on March 1, 2001, which were purchased by a fourth Catholic fraternal benefit society, Catholic Union of Texas. At the time of examination fieldwork, CKFS owned 1,160 shares of the 1,515 total issued and outstanding shares of CFSC capital stock, representing a majority 76.57% ownership interest in CFSC.

CFSC is registered as an investment securities broker/dealer with the National Association of Securities Dealers (NASD), and is licensed in thirty-five states to sell equity-based products and investment securities. CFSC was an inactive corporation from the time of its formation in 1994 through 1998, at which time it initiated operations for its brokerage business. CFSC provides the society with the capability to market through securities-licensed Catholic Knights agents various non-traditional investments and services, including mutual fund products and variable tax-shelter annuity policies, which are not written by the society. CFSC sponsors The

Catholic Funds, Inc., a family of mutual funds. Investments and services marketed through CFSC provide to society members additional elements of overall financial planning and investment that supplement the life insurance and annuity products written on a direct basis by Catholic Knights.

As of December 31, 2000, the audited financial statements of CFSC reported total assets of \$695,979, total liabilities of \$83,124, and total ownership equity of \$612,855.

Operations for 2000 produced a net loss of \$738,674.

### **Catholic Brokerage Services**

Catholic Brokerage Services (CBS) was incorporated November 11, 1994 as a Wisconsin stock corporation. All of the issued and outstanding capital stock of CBS is issued to and held by CKFS. CBS is an insurance brokerage company, and provides to the society the capability to market through society agents certain indemnity insurance products written by commercial carriers in business lines that are not written by the society. Brokered insurance products include accident and health insurance and long-term care coverage insurance. The society screens the brokered-insurance policies and underwriters, in an attempt to ensure that members are provided with good insurance products issued by reliable insurers.

As of December 31, 2000, the un-audited financial statements of CBS reported total assets of \$55,111, total liabilities of \$1,300, and total equity of \$53,811. Operations for 2000 produced total commissions revenue of \$27,099, and produced net income of \$9,236.

### **Affiliated Agreements**

Catholic Knights charges certain cost allocations to its subsidiary CFSC for services provided to the subsidiary by the society. Pursuant to a resource sharing agreement established in 1999, the society provides CFSC with the services of society employees and the use of society equipment and facilities to the extent necessary to enable CFSC to conduct its operations as investment adviser and broker-dealer for The Catholic Funds.

Service fees charged to CFSC for the costs of society services are based on time and cost allocation estimates for employees directly and substantially involved with CFSC. The estimates of time and cost allocation are amended by the society periodically as needed, to update the allocation model to reflect changes in services provided. Direct costs incurred by

Catholic Knights on behalf of CFSC that are not covered by the services categories specified in the management services agreement are charged to the affiliate on an monthly basis.

## **V. REINSURANCE**

The society's reinsurance portfolio and strategy are described below. The society's reinsurance program cedes certain insurance risks to other insurers. The society currently does not assume any reinsurance risks. Each of the society's current reinsurance contracts contains proper insolvency provisions.

### **Ceding Contracts**

Catholic Knights maintains reinsurance contracts that cede excess and catastrophic coverages on the society's direct written business. Some of the society's reinsurance treaties have existed for more than 20 years. The society's primary reinsurance agreement for life risks is a yearly renewable term automatic and facultative individual cession agreement with Lincoln National Life Insurance Company (Lincoln). The society's maximum life insurance retention for any single life is \$225,000. Society retention limits on life insurance are graded down by age and underwriting class, and decrease based upon the age and rating of the insured. Society retention on accidental death risks is \$10,000 per policy. The treaty provides reinsurance coverage on each ceded life risk equal to 400% of the society's retained amount up to age 65, and provides coverage on each ceded disability risk for 400% of the waiver of premium benefit retained by the society, for ages 15 to 55. Reinsurance coverage for each accidental death risk equals 100% of loss incurred in excess of the society's retention.

The society maintains a catastrophic excess of loss reinsurance treaty with The Canada Life Assurance Company that provides excess of loss reinsurance coverages for each loss occurrence in which there are three or more deaths on lives insured by the society. The reinsurance contract provides coverage for 100% of loss from each catastrophic loss occurrence in excess of society loss retention of \$150,000 for each individual ordinary life risk and \$35,000 for each individual accidental death benefit risk. The contract provides excess reinsurance coverage to a maximum of \$185,000 any one life, and has a maximum reinsurance indemnity limit of \$3 million for each loss occurrence and an annual maximum reinsurance indemnity limit of \$6 million.

The society maintains various reinsurance contracts with Lincoln and with Valley Forge Life Insurance Company whereby the society obtains automatic and facultative coinsurance

coverages for excess insurance risks on certain of the society's term life insurance plans and policies. The society's maximum loss retention is \$150,000 for each insured life on each of its reinsurance agreements ceding term life insurance risks.

Effective February 5, 1999 the society entered into a Direct Marketing and Reinsurance Agreement in which the society, the society's primary reinsurer, and a direct marketing company are contracting parties. Under the agreement, the reinsurer and the direct marketing firm agree to collaborate with the society in developing and conducting direct marketing campaigns targeted toward the society's existing policyholders, for the purposes of adding accidental death benefit coverages to existing life insurance policies. Under the contract's reinsurance provisions, the society cedes to the reinsurer on original terms a 50% quota share of the business resulting from the marketing campaigns covered by the agreement. The business ceded is subject to a maximum retention by the society of up to \$150,000 of life and accidental death benefits liability on each life. In no event does the society retain less than \$25,000 of the policies reinsured under the agreement. The society's retention is graded and decreases based upon the age and rating of the insured. The reinsurer's quota share percentage is 50% of the subject policies plus any excess that the society is unable to retain, to a maximum reinsurance coverage of \$225,000 each life. The reinsurer pays the society an agent commission and an administrative allowance based on an agreed percentage of the ceded first-year annualized premiums.

Effective January 1, 2001, the society entered into a long term care proportional reinsurance contract with a reinsurance group having six participating reinsurers, the two largest-participation reinsurers being American United Life Insurance Company and Equitable Life Assurance Society. Under the long term care reinsurance contract, the society cedes to the reinsurer a 75% quota share liability for all payments that are payable to each insured under the society's long term care extended benefits rider. The society retains liability for a 25% quota share of all payments due to each insured on all of the long-term care extended benefit riders. The contract will remain continuously in force for a period of five-years from the effective date,

and thereafter may be terminated with respect to new business by either party giving at least 90 days notice to the other party.

## **VI. FINANCIAL DATA**

The following financial statements reflect the financial condition of the society as reported in the December 31, 2000, annual statement to the Commissioner of Insurance. Also included in this section are schedules that report on the growth of the society, NAIC Insurance Regulatory Information System (IRIS) ratio results during the period under examination, and the compulsory and security surplus calculation as of year-end 2000. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Members' Surplus per Examination."



**Catholic Knights  
Assets  
As of December 31, 2000**

	<b>Ledger Assets</b>	<b>Nonledger Assets</b>	<b>Nonadmitted Assets</b>	<b>Admitted Assets</b>
Bonds	\$431,315,140			\$431,315,140
Stocks:				
Common stocks	22,414,680	\$2,674,114		25,088,794
Mortgage loans on real estate:				
First liens	38,816,008			38,816,008
Other than first liens	15,286			15,286
Real estate:				
Occupied by the society	2,236,960			2,236,960
Certificate loans and liens	20,146,913			20,146,913
Cash	2,088,177		\$6,968	2,081,209
Short-term investments	7,212,801			7,212,801
Other invested assets	5,501,955			5,501,955
Reinsurance ceded:				
Amounts recoverable from reinsurers	50,000			50,000
Electronic data processing equipment	1,609,133			1,609,133
Life premiums and annuity considerations deferred and uncollected	31,199			31,199
Investment income due and accrued	7,023,312			7,023,312
Other assets non-admitted:				
Fieldworkers' balances	182,289		182,289	
Bills receivable	68,796		68,796	
Furniture and equipment	684,796		684,796	
Cash advanced to or in hands of officers or fieldworkers	10,715		10,715	
Write-ins for other than invested assets:				
Prepaid pension	565		565	
Prepaid expenses	110,702		110,702	
Advance supplemental contract payments	223,016			223,016
Security deposits	8,527			8,527
Prepaid salaries	3,931			3,931
<b>Total Assets</b>	<b><u>\$539,754,901</u></b>	<b><u>\$2,674,114</u></b>	<b><u>\$1,064,831</u></b>	<b><u>\$541,364,184</u></b>

**Catholic Knights**  
**Liabilities, Surplus, and Other Funds**  
**As of December 31, 2000**

Aggregate reserve for life certificates and contracts	\$447,855,158
Aggregate reserve for accident and health certificates	333,242
Supplementary contracts without life contingencies	3,241,341
Certificate and contract claims:	
Life	665,314
Accident and health	272,381
Refund accumulations	8,300,194
Provision for refunds payable in following calendar year:	
Not yet apportioned	3,569,670
Premiums and annuity considerations received in advance	1,321,655
Liability for premium and other deposit funds	11,375,727
Certificate and contract liabilities not included elsewhere:	
Surrender values on canceled certificates	
Other amounts payable on reinsurance	92,125
Interest maintenance reserve	2,476,541
Commissions to fieldworkers due or accrued	97,152
General expenses due or accrued	1,112,790
Taxes, licenses, and fees due or accrued	132,743
Unearned investment income	620
Amounts withheld or retained by society as agent or trustee	195,450
Amounts held for fieldworkers' account, including fieldworkers' credit balances	7
Remittances and items not allocated	46,254
Miscellaneous liabilities:	
Asset valuation reserve	9,298,422
Write-ins for liabilities:	
Uncashed drafts and checks pending escheatment	3,901
Other accounts payable	<u>1,160,845</u>
Total Liabilities	491,551,532
Unassigned funds (surplus)	<u>49,812,652</u>
Total Surplus	<u>49,812,652</u>
Total Liabilities, Surplus, and Other Funds	<u>\$541,364,184</u>

**Catholic Knights  
Summary of Operations  
For the Year 2000**

Premiums and annuity considerations	\$33,221,444
Considerations for supplementary contracts with life contingencies	875,615
Considerations for supplementary contracts without life contingencies and refund accumulations	2,558,716
Net investment income	35,519,747
Amortization of interest maintenance reserve	423,705
Commissions and expense allowances on reinsurance ceded	7,978
Miscellaneous income:	
Write-ins for miscellaneous income:	
Surrender charges	5,543
Other miscellaneous income	122
Lease revenue	16,070
Donations of members	<u>59,567</u>
Total income items	72,688,507
Death benefits	6,227,335
Matured endowments	159,123
Annuity and old age benefits	3,043,389
Disability, accident, and health benefits including premiums waived	324,012
Surrender benefits	22,929,626
Interest on certificate or contract funds	665,315
Payments on supplementary contracts with life contingencies	1,787,873
Payments on supplementary contracts without life contingencies and of refund accumulations	2,304,872
Increase in aggregate reserve for life and accident and health certificates and contracts	16,015,816
Increase in reserve for supplementary contracts without life contingencies and for refund accumulations	<u>718,610</u>
Subtotal	54,175,971
Commissions on premiums, annuity considerations, and deposit-type funds	2,681,980
General insurance expenses and fraternal expenses	10,955,873
Insurance taxes, licenses and fees	<u>511,638</u>
Total deductions	<u>68,325,462</u>
Net gain from operations before refunds to members	4,363,045
Refunds to members	<u>3,506,695</u>
Net gain from operations after refunds to members and before realized capital gains	856,350
Net realized capital gains	<u>852,724</u>
Net Income	<u><u>\$ 1,709,074</u></u>

**Catholic Knights  
Cash Flow  
As of December 31, 2000**

Premiums and annuity considerations	\$33,226,617	
Considerations for supplementary contracts with life contingencies	875,615	
Considerations for supplementary contracts without life contingencies and refund accumulations	2,558,716	
Net investment income	35,719,727	
Commissions and expense allowances on reinsurance ceded		
Write-ins for miscellaneous income:		
Surrender charges	5,543	
Other miscellaneous income	122	
Lease revenue	16,070	
Donations from members	<u>59,567</u>	
Total		\$72,461,977
Death benefits	6,591,743	
Matured endowments	159,123	
Annuity and old age benefits	3,043,389	
Disability, accident and health benefits	141,255	
Surrender benefits	22,929,626	
Interest on certificate or contract funds	665,404	
Payments on supplementary contracts with life contingencies	1,787,873	
Payments on supplementary contracts without life contingencies and of refund accumulations	<u>2,304,873</u>	
Subtotal	37,623,286	
Commissions on premiums, annuity considerations and deposit type funds	2,667,704	
General insurance expenses and fraternal expenses	11,209,457	
	509,889	
Refunds to members paid	<u>3,458,440</u>	
Total deductions		<u>55,468,776</u>
Net cash from operations		\$16,993,201
Proceeds from investments sold, matured, or repaid:		
Bonds	49,233,074	
Stocks	7,798,481	
Mortgage loans	6,123,443	
Other invested assets	<u>78,669</u>	
Total investment proceeds		63,233,667
Cost of investments acquired (long-term only):		
Bonds	61,248,208	
Stocks	7,743,731	
Mortgage loans	2,685,698	
Real estate	136,728	
Miscellaneous applications	<u>6,291</u>	
Total investments acquired		71,820,656
Net increase in certificate loans and liens		<u>295,526</u>

Net cash from investments		(8,882,515)
Cash provided from financing and miscellaneous sources:		
Other cash provided	<u>1,399,411</u>	
Total		1,399,411
Cash applied for financing and miscellaneous uses:		
Other applications	<u>2,202,770</u>	
Total		<u>2,202,770</u>
Net cash from financing and miscellaneous sources		<u>(803,359)</u>
Net change in cash and short-term investments		7,307,327
<b>Reconciliation</b>		
Cash and short-term investments,		
December 31, 1999		<u>1,986,683</u>
Cash and short-term investments,		
December 31, 2000		<u>\$9,294,010</u>

**Catholic Knights  
Compulsory and Security Surplus Calculation  
December 31, 2000**

Assets		\$541,364,184	
Less liabilities		<u>491,551,532</u>	
Adjusted surplus			\$49,812,652
Annual premium:			
Individual life and health	\$20,067,455		
Factor	<u>15%</u>		
Total		3,010,118	
Greater of 7.5% of consideration or 2% of reserves for annuities and deposit administration funds		<u>3,725,596</u>	
Compulsory surplus (subject to a \$2,000,000 minimum)			<u>6,735,714</u>
Compulsory surplus excess			<u>43,076,938</u>
Adjusted surplus			49,812,652
Security surplus: (140% of compulsory surplus, factor reduced 1% for each \$33 million in premium written in excess of \$10 million with a minimum of 110%)			<u>9,430,000</u>
Security surplus excess			<u>\$40,382,652</u>

**Catholic Knights  
Reconciliation and Analysis of Surplus  
For the Five-Year Period Ending December 31, 2000**

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
Surplus, beginning of year	\$39,735,148	\$41,447,754	\$44,516,713	\$46,169,308	\$49,135,077
Net income	2,086,018	2,656,872	2,003,774	3,107,045	1,709,074
Change in net unrealized capital gains or (losses)	306,529	994,241	1,297,203	1,165,794	(1,880,624)
Change in nonadmitted assets and related items	345,529	8,790	(34,240)	(45,860)	183,273
Change in asset valuation reserve	(1,025,853)	(590,944)	(1,614,142)	(1,261,210)	665,852
Surplus, end of year	<u>\$41,447,754</u>	<u>\$44,516,713</u>	<u>\$46,169,308</u>	<u>\$49,135,077</u>	<u>\$49,812,652</u>

**Catholic Knights Insurance Society  
Insurance Regulatory Information System  
For the Five-Year Period Ending December 31, 2000**

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination. During the period under review there were no exceptional IRIS ratio results.

	<b>Ratio</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
#1	Net change in surplus	4%	7%%	4%%	6%%	1%
#2	Net income to total income	3%	4%	3%	4%	2%
#4	Adequacy of investment income	167%	157%	152%	152%	146%
#5	Non-admitted to admitted assets	0%	0%	0%	0%	0%
#6	Total real estate & mortgage loans to cash & invested assets	9%	9%	9%	9%	8%
#7	Total affiliated investments to surplus	1%	1%	2%	2%	2%
#8	Surplus relief	0%	0%	0%	0%	0%
#9	Change in premium	-4%	3%	1%	1%	-4%
#10	Change in product mix	3.2%	1.3%	0.3%	0.8%	0.4%
#11	Change in asset mix	0.3%	0.4%	0.2%	0.3%	0.2%
#12	Change in reserving ratio	0%	-1%	0%	-6%	-4%

**Growth of Catholic Knights**

<b>Year</b>	<b>Admitted Assets</b>	<b>Liabilities</b>	<b>Members' Surplus</b>
1996	\$452,888,211	\$411,440,458	\$41,447,754
1997	476,860,663	432,343,950	44,516,713
1998	502,520,271	456,350,963	46,169,308
1999	525,154,393	476,019,316	49,135,077
2000	541,364,184	491,551,532	49,812,652

**Life Insurance In Force (in thousands)**

<b>Year</b>	<b>Gross Direct and Assumed</b>	<b>Ceded</b>	<b>Net</b>
1996	\$2,529,076	\$224,897	\$2,304,179
1997	2,651,271	260,441	2,390,830
1998	2,720,761	284,893	2,435,868
1999	2,746,174	306,973	2,439,201
2000	2,749,262	335,967	2,413,295

### Accident and Health

Year	Net Premiums Earned	Net Losses Incurred	Commissions Incurred	Other Expenses Incurred	Combined Loss and Expense Ratio
1996	\$171,445	\$263,079	\$0	\$58,029	188.5%
1997	104,671	101,779	0	53,678	148.5%
1998	88,494	252,141	0	44,270	337.0%
1999	78,955	72,807	0	46,563	151.2%
2000	69,292	132,401	0	40,843	250.0%

Catholic Knights' total life insurance in force increased from \$2.4 billion in 1995 to \$2.7 billion in 1999, and remained at that level in 2000. The society had somewhat erratic sales year-to-year from 1995 to 2000, and experienced an overall trend of flat or declining life insurance premium income similar to that experienced by other small to medium size fraternal and commercial life insurers during the period. Annual new life insurance issued peaked at \$293,075,000 in 1996, and subsequently decreased annually to \$186,712,000 in 2000. The society's 2000 premium income of \$33.2 million was 2% less than premium income in 1995. Annual refunds to members have remained consistent during the period at approximately \$3.5 million, and the annual insurance expense percentage has consistently been approximately 36% from 1995 to 2000.

The society had net gains from life insurance operations in each year under review, and had net operating gains from annuities in each year except 2000. Annuity operating income in 2000 decreased due to a reduction in interest rate spreads on annuity products and an increase in death claims. During the examination period the society took various actions to increase its membership and to enhance its competitive position in the Catholic marketplace, including the establishment of society membership qualifications not based on an individual's status as a policyholder of society insurance products, expanded fraternal benefit programs, and the establishment of subsidiary operations through which the society markets a portfolio of non-insurance financial products and services.



## Reconciliation of Members' Surplus per Examination

The following schedule is a reconciliation of members' surplus between that reported by the society and as determined by this examination:

Members' surplus December 31, 2000, per annual statement			\$49,812,652
	<b>Increase</b>	<b>Decrease</b>	
EDP Equipment		\$1,309,706	
Prepaid Salaries		3,931	
Receivable from Subsidiaries	<u>\$28,149</u>	<u></u>	
Net increase or (decrease)	<u>\$28,149</u>	<u>\$1,313,637</u>	<u>(1,285,488)</u>
Members' surplus December 31, 2000, per examination			<u>\$48,527,164</u>

### Examination Reclassifications

	<b>Debit</b>	<b>Credit</b>	
Bonds	\$2,000,000		
Other Invested Assets	<u></u>	<u>\$2,000,000</u>	
Total reclassifications	<u>\$2,000,000</u>	<u>\$2,000,000</u>	

## VII. SUMMARY OF EXAMINATION RESULTS

### Compliance with Prior Examination Report Recommendations

The society's prior examination report contained three specific comments and recommendations regarding financial matters and five comments and recommendations regarding market conduct matters. The scope of the current examination is limited to matters of financial regulation, and the report does not include a review of prior examination comments and recommendations pertaining to market conduct regulation

Comments and recommendations contained in the last examination report and subsequent corrective actions taken by the society during the period under examination, are summarized as follows:

1. Corporate Executive Officers—It is recommended that the society amend its articles of incorporation or its bylaws to provide for three or more principal offices to be held by three or more natural persons in compliance with s. 614.12 (3), Wis. Stat.

Action—The society made amendments to their bylaws to address this issue, however additional examination comment and recommendation is included in the findings section of this report captioned "Corporate Executive Officers."

2. Holding Company Compliance—It is recommended that the society file a Form B and Form C insurance holding company filing, in compliance with s. Ins 40.03 (1), Wis. Adm. Code, by June 1, 1997, for calendar-year 1996, and annually thereafter.

Action—Compliance

3. Intercompany Transactions—It is recommended that the society establish formal intercompany agreements with its subsidiary firms with regard to intercompany services, cost allocation, or other intercompany exchange arrangements if affiliate operations expand and become material.

Action—Compliance. The society established a formal intercompany services allocation agreement with one of its subsidiaries during the years under examination.

## **Summary of Current Examination Results**

### **Corporate Executive Officers**

Pursuant to s. 614.12 (3), Wis. Stat., the articles or bylaws of a fraternal insurer shall specifically designate three or more officers, the holders of which shall be the principal officers of the fraternal. The principal offices shall be held by at least three separate persons. The prior examination determined that the society was not in compliance with the above requirements for its principal executive offices, and recommended that the society amend its articles of incorporation or its bylaws to provide for three or more principal offices to be held by three or more natural persons.

The society amended its bylaws to provide that the officers of the society are the President, the Secretary/Treasurer, one or more Vice Presidents, and Chairman of the Board. The society's Vice President(s) are appointed by and serve at the pleasure of the President, and their offices have only such duties as are assigned from time to time by the President or the Board of Directors. The office of Chairman of the Board can be held only by the immediate past President, and is vacant.

The examination determined that the offices of Vice President currently provided for in the bylaws are assistant officers as defined in s. 181.0840 (2), Wis. Stat., and are not principal offices of the society. The society does not have at least three principal executive offices occupied by at least three separate natural persons. It is recommended that the society amend its articles of incorporation or its bylaws to provide for three or more principal offices to be held by three or more natural persons, in compliance with s. 614.12 (3), Wis. Stat.

### **Other Invested Assets**

Other invested assets reported by the society as of year-end 2000 consisted of two surplus note investments issued by insurance companies and one capital note investment issued by a securities brokerage firm. NAIC annual statement instructions provide that an insurer shall report in Schedule BA the insurer's investments in surplus notes and capital notes issued by an insurance company. The society's investments in surplus notes issued by insurers was properly reported in the society's 2000 statutory financial statements.

The society's capital note asset, which was issued by a non-insurer, is restricted under SEC rules that qualify the security to be classified as capital rather than debt on the issuing company's balance sheet. However, the capital note investment does not qualify for society classification as a Schedule BA surplus notes asset, and the capital note should have been classified and reported in Schedule D as a bond asset. The examination made a reclassification of \$2,000,000 to classify the capital note investment as a bond asset. It is recommended that the society report all capital note invested assets issued by non-insurers as bond assets in Schedule D of the society's statutory annual statements, in conformity with the NAIC Annual Statement Instructions—Fraternal.

#### **Affiliated Balances**

As of year-end 2000, the society had a receivable of \$28,149 due from the society's subsidiary CFSC. The receivable was for costs allocated by the society to CFSC pursuant to an affiliated resource sharing agreement. The society's receivable should have been reported as an admitted asset under the caption "Receivable from subsidiaries and affiliates," but was reported as an element in the society's non-admitted "bills receivable" asset. The examination reclassified the account receivable as an admitted asset, and made an adjustment of \$28,149 to reflect examination classification of the affiliated receivable balance as an admitted asset. The society settles its affiliated balances monthly, and the year-end 2000 receivable balance was collected in January 2001. It is recommended that the society classify and report affiliated receivable assets as a separately identified admitted asset in the society's statutory financial statements, in conformity with the NAIC Annual Statement Instructions—Fraternal.

#### **Prepaid Salaries:**

As of year-end 2000, the society reported a prepaid salaries admitted asset of \$3,931. The asset pertained to compensation prepaid to one employee, under the society's-permitted option for the payment of an employee's annual salary increase in one lump sum upon authorization of the salary increase. The society classified the prepaid salaries account as an admitted asset, whereas the account should be classified and reported as a non-admitted asset. The examination reclassified the balance as non-admitted and made an adjustment to reported

year-end 2000 surplus, reducing reported surplus by \$3,931 to reflect proper classification of the prepaid salary balance as a non-admitted asset. It is recommended that the society properly classify all of its prepaid expenses as non-admitted assets, in conformity with the NAIC Accounting Practices and Procedures Manual.

### **EDP Equipment**

As of year-end 2000 the society included computer applications software of \$1,309,706, net of accumulated depreciation, in the society's reported admitted assets. The application software should have been non-admitted in the society's 2000 financial reports. The society became aware that the NAIC codification of statutory accounting practices that took effect January 1, 2001 excludes application software from an insurer's admitted assets, and the society reclassified its application software as a non-admitted asset effective on the first day of 2001. The society is in compliance with the NAIC codification of statutory accounting practice applicable to 2001 for computer application software.

Because the society corrected its practice subsequent to year-end 2000 and now correctly classifies its application software as a non-admitted asset, the examination did not make a recommendation pertaining to EDP application software. The examination made an adjustment to reported year-end 2000 surplus, reducing the reported surplus by \$1,309,706 to reflect classification of the application software as a non-admitted asset as of December 31, 2000.

## **VIII. CONCLUSION**

Catholic Knights is a Wisconsin-domiciled fraternal society originally incorporated in 1885 as the Catholic Knights of Wisconsin. The present name was adopted in 2000. The society is licensed as an insurer under chapter 614, Wis. Stats., and is currently licensed in eleven states. The society's business is concentrated in four Midwestern states, and most of its premiums are written in Wisconsin. Catholic Knights is a direct writer of individual insurance products, including ordinary and interest-sensitive whole life, term life, disability income (policy renewals only), and single and flexible premium deferred annuities.

From 1995 to year-end 2000, gross life insurance in force increased by 16% to \$2.7 billion, and net life insurance in force increased by 10% to \$2.4 billion. As of December 31, 2000, the company reported annual premiums and annuity considerations of \$33,221,444, and net income of \$1,709,074. During 2000 the society derived 71% of its premium income from its life insurance business and 29% from annuity writings.

During the period since the previous examination, society membership increased to 79,309 in 1997 and subsequently decreased to 75,506 at year-end 2000. During the past several years the society has taken various steps to increase its membership, to expand its traditional insurance and non-traditional financial services business, and to broaden the scope of its fraternal mission. The society reformulated its membership qualification criteria to remove ownership of an insurance policy as a membership requirement. The society capitalized and initiated operations of subsidiary mutual fund brokerage and financial services companies. The subsidiary companies provide members with mutual fund investment products and various insurance services that are outside the society's licensure authority to transact traditional life insurance and annuity business..

The examination made four recommendations, pertaining to principal corporate officers, classification of bond assets, recognition of affiliated receivables, and classification of prepaid expense assets. The examination made three adjustments of account balances that reduced admitted assets and surplus reported by the society in its year-end 2000 statutory financial statement by the net amount of \$1,285,488. The examination determined that as of

December 31, 2000 the society had total admitted assets of \$540,078,696, total liabilities of \$491,551,532, and total capital and surplus of \$48,527,164.

## IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 33 - Corporate Executive Offices—It is recommended that the society amend its articles of incorporation or its bylaws to provide for three or more principal offices to be held by three or more natural persons, in compliance with s. 614.12 (3), Wis. Stat.
2. Page 34 - Other Invested Assets—It is recommended that the society report all capital note invested assets issued by non-insurers as bond assets in Schedule D of the society's statutory annual statements, in conformity with the NAIC Annual Statement Instructions—Fraternal.
3. Page 34 - Affiliated Balances—It is recommended that the society classify and report its affiliated receivable assets as a separately identified admitted asset in the society's statutory financial statements, in conformity with the NAIC Annual Statement Instructions—Fraternal.
4. Page 35 - Prepaid Salaries—It is recommended that the society properly classify all of its prepaid expenses as non-admitted assets, in conformity with the NAIC Accounting Practices and Procedures Manual.



## **X. ACKNOWLEDGMENT**

The courtesy and cooperation extended during the course of the examination by the officers and employees of the society is acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, state of Wisconsin, participated in the examination:

<b>Name</b>	<b>Title</b>
Christine Shan	Insurance Financial Examiner
Sarah M. Haeft	Insurance Financial Examiner
Jean Suchomel	Insurance Financial Examiner

Respectfully submitted,

Thomas E. Rust  
Examiner-in-Charge